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C O N F I D E N T I A L SECTION 01 OF 02 QUITO 002509

SIPDIS

STATE PASS TO USTR BENNETT HARMAN

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TAGS: [EPET](#) [ETRD](#) [ECON](#) [EC](#)

SUBJECT: OXY: THE CALM BEFORE THE STORM - OR PROGRESS?

REF: A. QUITO 2462

[B](#). QUITO 2418: QUITO 2380

[C](#). QUITO 2327

Classified By: Ambassador Kristie A. Kenney, Reasons 1.4 (b), (d)

[1](#). (C) Summary. Occidental Petroleum's (Oxy) meetings in the US and USG efforts have provided a temporary calm in the contract nullification process. Oxy has still not been officially notified of its alleged violations of the hydrocarbon law, thus the statutory time period for it to respond has not commenced. Privately, the Procurador (Solicitor General equivalent) has said he would support a negotiated settlement with Oxy, but said he could not say so publicly. GOE sources think an offer for a negotiated settlement could be tabled in the next 2-3 weeks. Oxy is pleased with the calm, but is also waiting for the possible storm ahead. Canadian oil company EnCana's international arbitration is back on track. Likely unrelated, but worth consideration, EnCana's pipeline was recently vandalized/sabotaged causing an oil spill and environmental damage. End Summary.

Washington Meetings Successful

[2](#). (C) Economy and Finance Minister Mauricio Yopez told Ambassador on September 14 that his meetings with Oxy in New York were productive and opened the door to a negotiated settlement. He also mentioned that A/S Tony Wayne had raised the Oxy matter during their meeting. When Yopez returned to Quito on September 13, he spoke with President Gutierrez, Minister of Government Raul Baca and the Procurador about Oxy. All agreed that a negotiated settlement was the route to take and that none of them wanted to nullify Oxy's contract. Though, Yopez told the Ambassador that the Procurador said he could not say so publicly. Yopez said he did not discuss the Oxy matter with Minister of Energy and Mines Eduardo Lopez, because Lopez was too scared to take action. Still, Yopez thought the parties could put an offer on the table within the next 2-3 weeks.

[3](#). (C) Minister of Trade Ivonne Baki also told Ambassador September 13 that she had received a strong message from USTR that Oxy and other commercial disputes had to be quickly resolved or Ecuador would face serious trade consequences. Baki said she too explained this to Gutierrez.

Public Debate Less Polemical - For Now

[4](#). (C) Procurador Borja announced September 14 in the press that he would continue to review all oil company contracts for compliance with Ecuadorian law. Next on the list is Canadian oil company EnCana. However, Borja's statements were not inflammatory. Ecuadorian Ambassador to the USA Raul Gangotena's comments on a local radio show were conciliatory towards Oxy and stressed the need to work out a long term relationship with the company. However, Minister of Energy Lopez is scheduled to appear before the Ecuadorian Congress on September 17 and it is unclear whether he will wilt under Congressional pressure and adopt a more nationalistic attitude.

Oxy: Is It Progress or the Calm Before the Storm?

[5](#). (C) Oxy President and GM of Ecuador Jerry Ellis told econoff September 14 that Oxy thought its meeting with Yopez in New York had been productive. He also said that he was pleased that things were relatively calm in the press in recent days. He added that Oxy continues to be willing to negotiate a settlement, but it is unclear with whom they would negotiate. He agreed that Energy Minister Lopez was too afraid to take any action and that it was far from certain that the Procurador could be trusted, even though Borja eventually would probably have to approve any settlement agreement. He was waiting to see what Lopez would say before Congress and moderately encouraged by the fact that Oxy has yet to be officially notified of its alleged hydrocarbon law violations and the statutory time for Oxy's response had not yet begun.

16. (C) EnCana's GM John Keplinger told econoff on September 14 that the GOE had appointed its replacement arbitrator for EnCana's international arbitration case on the value added tax (VAT) refunds. Keplinger said that the final hearing in that VAT arbitration would be held on November 18 and they expected a decision in the first quarter of 2005. EnCana had closely followed Oxy's international arbitration case on the same topic. He noted that the Minister of Energy has refused to sign anything involving EnCana (the purchaser of Oxy's 40% share of Block 15, see reftels) or Oxy.

17. (C) Keplinger also told econoff that someone had either vandalized or sabotaged one of its pipelines. He said the person had to know something about what they were doing because they dug 1.5 meters to get to the underground pipeline and then used a power drill to penetrate the pipe. However, the vandals/saboteurs were not that expert, as oil flows through that pipeline at 700 psi; thus, the person drilling the hole received quite a jolt when the pipe was penetrated. He theorized that the shock scared the person/s off. EnCana security personnel do not believe this was an act by any of the Colombian insurgents, but continue their investigation.

18. (C) Unfortunately, because of the small size of the hole, the oil leak was not discovered for some time, until a local farmer notified EnCana. Some 11 hectares could be affected by the spillage of approximately 200 barrels of oil. Local colonos (settlers from other parts of Ecuador) living in the area tried to extract a \$25,000 payment from EnCana for access to repair the pipeline and clean up the environment. As a result, EnCana was forced to go to environmental authorities to get access to the land. Keplinger hoped that the incident was not a reaction to the recent developments in the oil sector involving Oxy and EnCana.

Comment

19. (C) Oxy is right to be wary of reaching a negotiated settlement with the GOE. Still, the right people in the GOE are involved, Ministers Yepez, Baca and Baki and President Gutierrez. However, the weak links are the two people that need to be most involved, Minister of Energy Lopez and Procurador Borja. It is a good sign that the statutory time for Oxy to respond has not commenced and that both parties have agreed on that is imperative to reach a settlement and keep Oxy in Ecuador. Our task now is to encourage the GOE to get a responsible person with the authority to act to sit down with Oxy sooner, rather than later. As long as problems like Oxy's VAT and contractual problems remain, Ecuador cannot hope to attract the foreign investment in the oil sector it desperately needs. As the case involving EnCana also points out, there are plenty more problems in the oil sector waiting for the GOE in the very near future. Responsible development of Ecuador's oil sector is crucial to its economic and political stability, both of which are in the USG's best interests.

KENNEY